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■ HOW JAPAN PICKS AMERICA'S BRAINS • GOODBYE, CORPOR

FORTUNE

DECEMBER 21, 1987 $3.50

THE VATICAN'S FINANCES

Why this great global institution is strapped for cash

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DECEMBER 21, 1987 VOL. 116, NO. 14

FORTUNE

"This is a real crisis. Anytime your operating income fails to cover expenses, you've got a problem."
PAGE 28

With revenues that will pass $800 million this year, Nucor maintains a corporate staff of only 17.
PAGE 65

"The Japanese buy the patent, perfect it, synthesize it, sell it, and reinvest the money in another patent."
PAGE 79

"Everybody can be a devil. Everybody can be an angel. Everybody. Even me."
PAGE 105

"Emotion that a voter has about a candidate is the only thing that might change his mind in the voting booth."
PAGE 131

Asked exactly what the Borden difference is, one veteran dairyman replied: "About a buck a gallon."
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THE EDITOR'S DESK

IT HAS RICHES and glory beyond imagination and yet faces a growing cash crisis. It recently convened a council of elder statesmen to figure a way out of its deficit. Are we talking about the U.S. government? Not quite. The Vatican, that great global institution with a charismatic leader and vast influence, faces a classic management problem: a cash squeeze. You don't have to be Catholic to be interested.

This is not a story that you will read about in *Osservatore Romano* or hear about on the Vatican Radio. The secretive Vatican bureaucracy puts out just one cryptic financial press release a year. But who better to get the story than FORTUNE's Paris bureau chief Shawn Tully? His family tree is peopled with two sisters of the Sacred Heart, one Jesuit, and one cardinal. He has degrees from Princeton, the University of Chicago, and the Catholic University of Louvain in Belgium. He has deciphered tangled finances as varied as those of commodities baron Marc Rich and Canada's Dome Petroleum. Yet, says Tully, "the story of the Vatican's finances was the toughest I've ever covered."

Tully camped in Rome for nearly a

P. ROBIN—SYGMA

Tully penetrated the Vatican while . . .

month, chasing more cardinals than a St. Louis sportswriter. At first, Giuseppe Cardinal Caprio, director of the Vatican's budget office, was stiff and silent. But apparently he was impressed by Tully's persistence. Three weeks later the cardinal received Tully warmly, and he and his staff spent three hours clarifying details. More missing numbers turned up when the 15 cardinals who supervise the finances convened for their semiannual meeting. They opened up.

Meanwhile, Marta F. Dorion, who has just been named FORTUNE's deputy chief of reporters, was gathering facts from church officials in the U.S. She wrote the accompanying box on the Springfield–Cape Girardeau diocese in Missouri, which although small and not wealthy makes the largest per capita contribution to the Vatican's annual collection, Peter's Pence.

We hope our cover package will clear up some myths about the Church's wealth. But Cardinal Caprio may have had it right when he told Tully that what happens to the Vatican's deficit "is in the hands of Providence."

. . . Dorion opened up the U.S. Church.

ANDY FREEBERG

Marshall Loeb
MANAGING EDITOR

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THE SMOKESTACKS STEAM AGAIN

U.S. industry is operating closer to capacity than it has since the late 1970s. That means shortages for some customers, but it is an overdue payoff for the long, lean years. ■ *by H. John Steinbreder*

REMEMBER deindustrialization? Not much more than a year ago it was a favorite topic for doomsayers who predicted the demise of the U.S. as a major manufacturing power. Look now at the healthy clouds of steam billowing from America's factories. What you're seeing is a Rust Belt revival.

Capacity utilization rates in the once sickly steel industry have risen nearly 20 percentage points in the past year and now are about 83%. Reynolds aluminum plants are operating at 100% of capacity, and the company is allocating supplies to customers for the first time in years. Mead Corp., which is breaking ground for a $500 million paperboard mill in Alabama, is among several paper companies trying to meet rising demand through expansion.

The results are clear on the income statements. The 26 largest U.S. steelmakers earned some $400 million during the first six months of the year, vs. cumulative losses of $12 billion since 1982. Earnings at Phelps Dodge, the copper producer, are expected to rise to $170 million this year, up from $64 million in 1986. Profits for chemical manufacturers bubbled up 40% last year and could climb another 20% in 1987. Paper industry revenues will probably reach a record $86 billion, 15% above last year's lush total. Profits for the first half broke records too, soaring 46% higher than 1986 figures for the same period. Many companies are using the cash to pare debt or to revive anemic capital spending. Says Charles I. Clough Jr., chief investment strategist for Merrill Lynch: "We are in the midst of an industrial renaissance."

Such news from smokestack America is heartening, especially after the market crash that dampened economic confidence. But the new optimism is tempered by fears of inflation. The demand that has brought greater capacity utilization and stronger profits is also pulling prices up.

So far the increases seem unlikely to generate serious inflation, but they are worrisome. Says Steven C. Mason, president of Mead Corp.: "As a businessman, I see prices just getting back to the levels of five years ago, which will allow us to modernize and expand. As a private individual, though, any time you see increases like these you have to consider them inflationary."

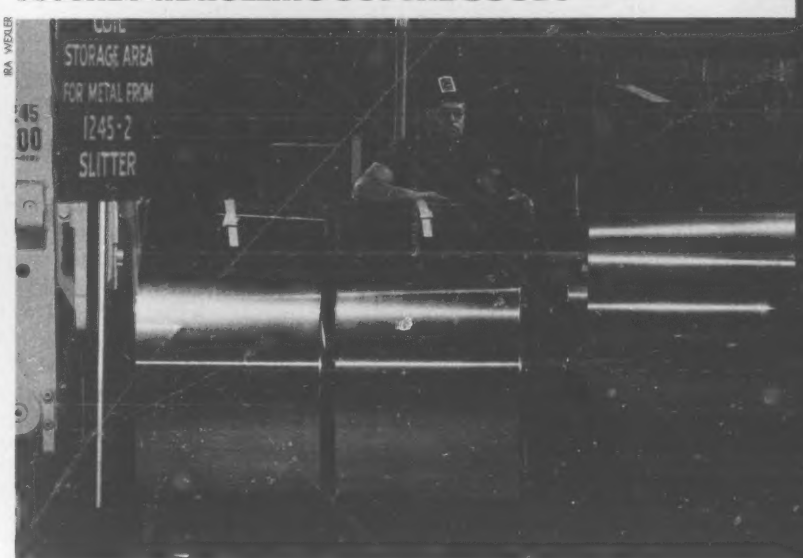
American industry has spent years getting ready for this party. The recession of the early 1980s forced companies to begin long-overdue restructuring and cost cutting. New factory construction all but stopped. At the same time, industry began mothballing antiquated plants and shutting down huge chunks of U.S. manufacturing and mining capacity. The copper industry, for example, has shrunk capacity by some 15% and cut its labor force by two-thirds, laying off nearly 20,000 workers. Copper producers invested heavily in new technology. Prices and profits

FROM PAPER TO ALUMINUM . . .

JAN STALLER

Business is booming at Mead Corp.'s coated-paper mill in Chillicothe, Ohio, and at the Reynolds plant in Sheffield, Alabama, that makes aluminum sheet for beverage cans. Both are operating near full capacity. Also thriving are producers of steel, copper, chemicals, textiles, and tires.

. . . THEY'RE ROLLING OUT THE GOODS



IRA WEXLER

rose dramatically, and so did productivity and competitiveness.

The party has steadily livened since the dollar began falling from its February 1985 peak. That has reduced prices of U.S. goods, reopened export markets, and rekindled demand at home for American products. The latest drop can only speed up the music. Manufacturers are buying more of their raw materials and components from U.S. suppliers. And some companies are beginning to repatriate offshore operations. Cross & Trecker, a leading machine tool maker, is scaling back a Japanese joint venture and returning some production to King of Prussia, Pennsylvania. Tandy recently brought some of its computer-making capacity from South Korea back to the States. Says Tandy's chief executive, John Roach: "Our production has moved many times from the U.S. to the Orient, but this is the first time we are moving from the Orient to the U.S."

Rising demand has helped lift capacity utilization for manufacturing to 81.7% in October, the highest level since March 1980. Companies in many industries—aluminum, paper, textiles, chemicals—are running at well above 90% of capacity.

Prices, as a result, have been climbing in several industries. Aluminum is up 55%, and copper nearly 90%. Some steel prices are up as much as 12%. Bethlehem Steel audaciously raised prices the day after the stock market crash in mid-October. Paper pulp has risen from $400 a ton to a record $580 a ton over the past two years. Linerboard prices have soared 15% this year, and newsprint around 10%.

SLOW DELIVERIES and bottlenecks are also pinching some customers. Says Raymond W. LeBoeuf, vice president for purchasing and distribution at PPG Industries: "As a buyer we are seeing shortages, and they are becoming more and more widespread. As a seller, we can't take additional customers for certain products." A major paper products customer agrees. "Some suppliers have already asked to be relieved of their contractual obligations," he says, "and in some cases we have deferred deliveries for a quarter or two at their request." Supply has been so tight in certain industries, reports Jerry Baker, executive vice president at the National Association of Purchasing Management, that "some businesses have turned to overseas producers to fill their short-term needs."

In a traditional economic expansion, the price increases and bottlenecks would be a sure sign of overheating. Witness what happened in 1973, when capacity utilization figures rose to historic highs. Producer prices, not including food and energy, jumped 25% after that.

But it's not so cut and dried this time. Some manufacturing sectors remain in the doldrums. Auto and machine tool makers, for example, are still stuck with overcapacity and strong foreign competition. GNP growth should plod along at 1.8% next year as the economic engines that have powered the revival sputter a bit, and demand will slacken. That should ease pricing pressures and calm most fears about galloping inflation.

FACTORIES ARE HEATING UP

INDUSTRY	CAPACITY UTILIZATION RATES 1987 latest	1967-86 avg.	1967-86 high
ALUMINUM	89.2%	87.4%	105% Aug. 1967
CHEMICALS	83.8%	78.7%	88.6% Oct. 1973
PAPER	96.1%	88.2%	95.8% Dec. 1972
RUBBER	86.6%	84.7%	98.5% Dec. 1972
STEEL	82.6%	78.6%	105.8% Dec. 1973
TEXTILES	94.5%	84.7%	92.5% June 1968

SOURCE: FEDERAL RESERVE

As the Rust Belt revival moves into high gear, many U.S. industries are approaching or passing their old highs of capacity utilization.

The economy probably won't pick up steam again until late 1988. In the meantime, bottlenecks in industries with capacity crunches should at most inconvenience customers. Despite the lower dollar, foreign suppliers remain available. They will serve both as a safety valve and as insurance against runaway price spirals.

In several industries companies are adding capacity. Textile manufacturers have put in some $2 billion worth of new equipment this year. The paper industry is pursuing plans that will boost production several million tons by 1990. Others adding capacity include the tire, chemical, and glass industries.

Some analysts now worry that smokestack America may be about to spend and build itself into another slump. For example, Cooper Tire & Rubber will increase capacity by 20% next fall even though President Ivan Gorr admits that "I don't see a marked change in worldwide demand for tires." The expansion in textiles troubles Jay Meltzer, an analyst at Goldman Sachs. Says he: "I think demand is going to stabilize, or possibly diminish, because much of it has been fueled by out-and-out inventory rebuilding."

A number of industrialists agree, and they are approaching the current boom with caution. Says David Roderick, chief executive of USX: "Given our experience during the past 20 years, I am not willing to risk our shareholders' money by expanding capacity just because our business has recently improved." Adds Robert Irelan, a Kaiser Aluminum vice president: "One thing that is very certain is that what goes up can come down quickly." At Kaiser, says Irelan, "we are not looking so much at increasing capacity as we are at getting our costs down so we can run in a very weak pricing scenario."

For some industries caution does seem warranted. Joel Popkin, an economic consultant in Washington, D.C., points out that steel and textile producers are doing well in part because of import quotas. If the quotas fall, or the dollar rises, those industries could be in trouble again.

But for most, worries about overexpansion seem like downright pleasure compared to the concerns of the recent past. Many had cut back so much early in this decade that they have to build new plants in order to keep from falling behind. Says Harry Millis, a tire industry analyst with McDonald Securities in Cleveland: "If the U.S tire companies don't expand, there are some foreign competitors who would just love to grab a larger share of the market." Even if the economy falters, most of these companies have cut costs to the point where they are better equipped to survive a slump than at any time in recent memory.

The sudden revival of smokestack America has created a sense of optimism that hasn't been seen since the late 1960s, when Cleveland's Cuyahoga River was so laced with industrial pollutants that it caught on fire. As Merrill Lynch's Clough puts it, "The long-awaited modernization of U.S. industry is upon us." Bullish on basic industry, he is convinced that "the rebuilding of our industrial plant will be the primary engine of economic growth in the next cycle."

The challenge for companies suddenly awash with orders and profits is to keep practicing the lessons they learned during their long and wrenching climb back to competitiveness. In any industry, after all, excess capacity is not so much a problem as an opportunity for the company that is successfully increasing productivity and lowering costs. It's the other guy who inherits the problems. F

REPORTER ASSOCIATE *Wilton Woods*

GOODBYE, CORPORATE STAFF

All kinds of companies are saving money and increasing efficiency by clearing out the crowd at headquarters. Watch out, lawyers, futurists, and other deep thinkers. ■ *by Thomas Moore*

GENERAL FOODS administers its empire from a gleaming monument of corpocracy that rises like an Aztec temple over a pond in Rye Brook, New York. But today the imposing architecture of the building and the headquarters organization it housed have become relics. Acquired by Philip Morris two years ago, General Foods recently announced it would dismantle its corporate staff hierarchy and eliminate most of its 2,000 headquarters jobs. An operating president will move his executives into the vacated offices; he and two other presidents will hire about half the people dumped by headquarters.

A corporation can slim down in lots of ways. U.S. companies seem to have tried them all, from selling off businesses to closing redundant plants. But an increasingly popular route to greater efficiency is cutting the corporate staff. That is the often vast collection of planners, economists, marketers, central purchasing agents, real estate managers, human-resources specialists, futurologists, other analysts, and deep thinkers who sit at headquarters and often annoy the operating executives by offering to help them. Says Robert Tomasko, author of the new book *Downsizing* and a partner at management consultants Temple Barker & Sloane: "Corporate staff is becoming an endangered species."

Some companies hack away indiscriminately, weakening critical control functions or lopping off valuable services. Others trim insufficiently or simply smoosh people around from one organization chart to another. But a few have shown how to slough off staff neatly. In many cases the employees who remain inhabit a strange new world in which decisions are quick, accountability is clear, and everyone is working harder.

Life in the new minimalist corporation is tougher but simpler. The small corporate headquarters may be located a thousand miles or more from principal operating units, as the Charlotte, North Carolina, office of steelmaker Nucor is. The new head office decides how to allocate corporate capital among internal and external investments, watches the investments closely, and replaces managers who do not meet budgets. Freed to manage their businesses, general managers decide what services they need and whether they should get them from corporate headquarters, from their own staffs, or from outside suppliers.

Many chief executives never felt comfortable with the entourages they allowed to grow around them. In 1953, in the early days of America's postwar managerial revolution, John L. McCaffrey, then chief of International Harvester, told FORTUNE: "We

TIM MANTOANI

The whole staff *but two gathers at the modest headquarters of Nucor (1986 sales: $755 million).*

REPORTER ASSOCIATE *Kelly Tasker*

sit at our desks all day while around us whiz and gyrate a vast number of special activities, some of which we only dimly understand. And for each of these activities, there is a specialist . . . All of them, no doubt, are good to have. All seem to be necessary. All are useful on frequent occasions. But it has reached the point where the greatest task of the president is to understand enough of all these specialties so that when a problem comes up he can assign the right team of experts to work on it."

Today, with U.S. corporations under pressure from foreign competition, these doubts have swelled into a managerial counterrevolution. Partners at McKinsey & Co., the management consultants often brought in to do hatchet work by bloated corporations too timid to draw their own blood, argue that the large staffs of traditional multibusiness corporations no longer serve much purpose in the U.S., Britain, and other developed economies.

BIG CORPORATIONS historically created value by recruiting and training talent and providing capital to invest in operations, explains Stephen Coley, a McKinsey principal in Chicago. They still do in developing countries. But in efficient economies, with sophisticated headhunters, investment bankers, and consultants for just about anything, corporations can buy these services and no longer need full-time staffs to provide them. "Our view is that value is created only in the operating units," says Coley. "The role of the corporation in a developed economy is to act as a demanding and farseeing parent, but not one that tries to do everything for the businesses it is trying to nurture."

Few companies have shown how to do that as successfully as Anglo-American conglomerate Hanson Trust (1986 revenues: $6 billion). "What Hanson does is go out and find corporate anachronisms—top-heavy, widely diversified companies—and then bust them up and get rid of corporate staff," says Coley. In the past 14 years its U.S. arm, Hanson Industries North America, has taken over ten companies, including two big industrial conglomerates, U.S. Industries and SCM Corp. Between 1982 and October's stock market crash, Hanson shares more than quadrupled in value; they have since fallen by a quarter. Hanson's latest move: a just-consummated $2.2 billion deal to buy Kidde Inc., another conglomerate that makes everything from Jacuzzis to pots and pans.

LARGE COMPANIES WITH SMALL STAFFS

It pays to keep lean at the top: Most of these abstemiously staffed giants have performed admirably in recent years.

	1986 SALES (millions)	EMPLOYEES TOTAL	EMPLOYEES HEADQUARTERS	SALES (millions) PER HEADQUARTERS EMPLOYEE
BURLINGTON NORTHERN	$6,941	43,000	77	$90
TRANSAMERICA	$7,120	15,200	100	$71
CSX	$6,345	52,000	100	$63
DANA	$3,695	36,000	72	$51
NUCOR	$755	3,700	17	$44
HANSON INDUSTRIES	$3,769	33,000	89	$42
HENLEY GROUP	$3,172	18,000	75	$42
HEINZ	$4,366	45,000	175	$25
BORG-WARNER	$3,623	82,000	175	$21
JAMES RIVER	$2,607	35,500	175	$15
BRUNSWICK	$1,717	18,700	180	$10

SOURCE: TEMPLE BARKER & SLOANE

Sir Gordon White, Hanson Industries' jet-setting chairman, holes up in an elegant Park Avenue office with a staff of 12, including secretaries and the company's one public relations officer. But the home of most of Hanson's top U.S. executives, which Sir Gordon rarely visits, is back-to-basics chic. The company leases part of the third and fourth floors of a modest four-story building in an exurban industrial park near the Amtrak train station in Iselin, New Jersey. Inside, Hanson's headquarters has the panache of an insurance company's back office. Almost all the furniture, right down to the framed prints and potted plants, are leftovers from USI and SCM.

As Hanson Industries has quadrupled in size in the past four years, its headquarters has grown only from 29 people to 89. That is a fraction of what many smaller U.S. companies employ. USI, for instance, had 172 and SCM 182 at headquarters. Hanson pools a dozen or so personal computers and does not own or lease a mainframe; it uses an outside payroll service. The company's total corporate expense, including salaries and office space, was $17 million last year—about one-quarter the combined corporate expenses of USI, SCM, and Hanson at the time of their mergers.

Hanson's organization chart is something a child can understand. Sir Gordon and President David Clarke are at the top. Reporting to Clarke are five corporate vice presidents in charge of law, finance, organization development, acquisitions, and operations. Six group vice presidents, each overseeing a batch of individual operating companies, report to the corporate VP for operations. The senior management group of 12 at Iselin is supported by 42 middle managers and 35 secretaries and clerks.

CLARKE, 46, an avid sailor who used to own a fishing business, professes to be astonished by the excess corporate baggage carried by most big companies, not to mention the grand life to which many top executives have become accustomed. That's a major reason he cites to explain American companies' loss of their competitive edge. He likens the atmosphere at pre-Hanson USI to a country club's. The company had moved from New York to a spacious new building with a view on Dolphin Cove, a picturesque inlet of Long Island Sound in Stamford, Connecticut. In the summer the staff knocked off at 5:30 P.M.—a half hour earlier than normal—and at noon on Fridays. "That is not an appropriate way to run a company," says Clarke. "We are fighting a war with the Japanese, the Taiwanese, and the Europeans, and you don't want your people sitting on a golf club green."

Quickly Clarke homed in on superfluous staff specialties. "We start out with a zero-base premise," he says. "We want to keep nothing more than what it takes to get the

job done." His first act: firing the four-person economics department. "I don't want economists taking away the authority of managers," he says. "As CEO, I want my managers to sign in blood what *they* think housing starts will be."

Then he got rid of 30 outside consultants: "Why should the company spend another $2 million a year to help me do my job?" He eliminated a central marketing department and the real estate department, which had not sold a parcel of property in three years. Clarke explains: "The problem with an inhouse capability for some thing like real estate is that this guy puts himself out of business if he achieves his goal, which is to liquidate property." Within a year Clarke sold USI's headquarters building for $9.4 million.

NINA BARNETT

Once a temple *for staff, General Foods' headquarters now houses mainly operating employees.*

AT SCM he pulled the plug on an immense data services center in North Carolina that cost $8 million a year. Though many streamlining companies are letting computer services grow, Clarke felt the center was overloading his executives with information, making it harder for them to reach decisions, not easier. He also jettisoned SCM's management training center on the Hudson River and its 26 staffers. "Hiring and developing the right people is the most important thing I do as a manager," he says. Strategic planners are another group of employees that bit the dust. Clarke reasons that strategy is too important to be left to experts; managers must do it themselves. Like most other executives, he says he gets no kick from firing people, but adds, "You shouldn't let the human element affect the basic business decision." He tolerates lawyers as a necessary evil and instructs them to resolve issues rather than prolong them.

Clarke maintains that keeping an organization streamlined is second in importance only to creating an excellent product at the right price. It's like sailboat racing, he says. He won the Newport-Bermuda race last year in part by staying lighter than most other boats. As competing craft loaded up on beer and food, sinking farther into the water, he took only the required five gallons of water per crew member plus dehydrated food to save weight. Rather than getting a good sleep below deck, the off-watch crew often clipped themselves to lifelines on deck to keep the boat sailing flat and fast.

"There was nothing in that boat that we didn't need to get to St. David's Lighthouse in Bermuda," Clarke says. "The old guard at the yacht clubs say minimalists like me are ruining the sport by making sailing unpleasant. But I'm not in it to be comfortable. The winning is the fun. That's the whole point."

A company that runs an even tighter ship than Hanson is Nucor, the feisty mini-mill company in North Carolina that is fast becoming a maxiplayer in steel manufacturing. Its big advantage is that it did not have to streamline—Nucor never built a giant staff. With revenues that will pass $800 million this year, it maintains a corporate staff of 17 people. "That's up 6% this year too, because we added a person," says Chief Executive Ken Iverson. Total corporate costs, including office space: $8.6 million last year, or a minuscule 1.3% of all costs. Corporate costs that rise above 5% begin to put an excessive burden on operating units, according to McKinsey. Nevertheless, some companies are hard put to keep them below 15%.

HOW DOES NUCOR do it? Iverson says CEOs ask him this question more than any other. He has decentralized his 14 divisions to the point where they could probably run by themselves if they had to. Each business operates as an autonomous company in a regional market, making all its operating decisions. The tiny central office monitors budgets, cash flow, and operations. Iverson occasionally employs consultants for economic forecasting but more often uses published forecasts on the steel industry he can consult for next to nothing. Strategic planning? He sits down three times a year with his general managers to discuss how to allocate the company's capital.

Hanson and Nucor are models for many of America's corporate behemoths as they begin the tough job of eliminating long-embedded staff. The simplest and most radical approach, many chief executives have concluded, is to let operating managers decide what corporate services—from public relations to real estate management—they are willing to pay for out of their own budgets. That's what General Foods is doing. "We wanted to make it easier for each of our operating companies to decide exactly what resources it needs to pursue its business interests," says Chairman Philip Smith. "They alone will decide what they need to be competitive."

continued

One of the dangers of decentralizing corporate staff is that a number of oversize staffs can bloom lower down in the organization. Example: Mobil. In its oil and gas operations Mobil long maintained some two dozen regional centers, a half dozen divisional offices, plus its New York corporate headquarters, all of which were staffed as if they were separate companies. As though guided by some internal genetic structure, each of these management centers cloned the staff group of the office to which it reported. Each generally employed 175 to 200 planners, lawyers, controllers, human-resources people, systems experts, and so on—some 6,000 altogether.

The little-company syndrome, as some Mobil executives referred to their bureaucratic malady, was costly, laborious, and a drag on decision-making. According to Don McLucas, head of human resources and the man who coordinated Mobil's cutback program, staff specialists often created their own lines of authority parallel to the operating hierarchy's. With staff matrices on top of matrices, decisions could take months, even years, as each management center conducted its own review and added its own recommendations to be considered by the next level. McLucas recalls that a $1 million decision by Mobil Française to buy a gas station in downtown Paris, for example, was reviewed by four additional management layers. The four: Mobil Europe, the international marketing and refining division, the worldwide marketing and refining division, and finally Mobil Oil Corp. in New York.

Trying to limit the staff at each center would often lead to long debates about precisely how many planners or accountants were necessary. McLucas says: "We concluded that if we didn't eliminate some of these management offices entirely—get rid of the whole goddamn thing—our reduction program wouldn't work."

MOBIL HAS HALVED its 24 regional offices to 12 in the past five years and reduced the duplication of staff at its six division offices and headquarters. Overall it has cut corporate staff by one-quarter—the same proportion by which it has reduced total employment. Staff jobs should be even fewer by 1990, when the oil giant expects to finish moving its corporate headquarters and divisional offices into one complex in Fairfax, Virginia.

As companies scale back corporate hierarchies, many are redefining the role of the head office. The notion of an elaborate system of checks and balances with parallel lines of reporting—which found its most extreme expression at ITT under Harold Geneen—is out. The new trend is to think of the corporate center as a small merchant bank or holding company, investing capital among various enterprises, monitoring the profitability of each against projections, replacing underachieving top managers, and constantly looking for new investment opportunities. As McKinsey's Coley says, "It doesn't take a cast of thousands to do that."

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Burlington Northern, the railroad and natural resources company, reorganized itself six years ago. It changed from a traditional integrated American corporation into a holding company. The headquarters staff, 50 to 60 managers, moved from St. Paul to Seattle. One reason: so they would not dabble in everyday operational problems back in St. Paul or worry general managers by looking over their shoulders. The operating managers compete for capital allocation—the best performers get the most capital—creating new pressures to run as lean as they can. Total employment at the railroad has fallen from 57,000 to 33,000. Its management group has shrunk from 6,000 to 3,700, with corporate staff sustaining a disproportionate share of the cuts. Computer services is the only area that has grown.

Even big, vertically integrated firms that don't want such a radical transformation are narrowing their corporate focus to basic strategic goals rather than tactics. Says Ford's human-resources chief, Peter Pestillo: "The corporate role at Ford has changed from audit and review, or the oversight of other people, to corporate strategy, or what the company ought to be doing."

Some companies have handed to corporate staff the job of reducing corporate staff. That arrangement rarely works well. AT&T tried it and has eliminated at least 12,000 staff jobs; it still has 18,300 left. The company is decentralizing, though perhaps not enough. It is dispersing many corporate functions, such as public relations and marketing, to seven regional hubs, each of which will serve AT&T's various businesses in that region. But ultimate authority remains firmly in New York. Hub staffs report to counterparts at headquarters, which also decides how to allocate corporate overhead costs to each of the units. "The operating managers don't have the choice to do without all staff services," admits Charles Marshall, AT&T's vice chairman for personnel, who adds that the managers often blame their skinny bottom lines on overhead charges.

YET LEFT ALONE—and with powerful motivation—AT&T operating managers have shown they can cut staff as well as anyone. After deregulation, fierce competition nearly drove out of business the division that makes and markets phone products. With the blessing of the New York headquarters, its operating manager, Victor Pelson, turned the business around by short-cutting corporate channels. "There was not time to go through the traditional organization and prepare reports and fancy review graphs," he says. "We had to toss the problems right in the laps of the line people."

They changed the entire product mix in 18 months, opened a factory in Singapore within a year, closed half the business offices and phone stores, and cut division staff by half, or some 10,000 people. Pelson says, "The traditional staffs were cut the most. We reduced senior vice presidents by two-thirds." Up to then such bold actions in such a short time were unheard of at AT&T. But no longer. Pelson has been promoted to head AT&T's general business systems division, where he is doing more of the same.

While staff reduction begins as a cost-cutting exercise, it usually accomplishes much more. Decisions are made faster; managers get closer to their markets. Companies that have shrunk staff find that these effects are almost always more valuable than the initial cost savings. Above all, paring the staff highlights a lesson that is often forgotten in good times and relearned in bad: Line managers are the stars of business. They probably know what they need to do their jobs. If they need help, let them ask for it—and pay for it. ■